Nos. 75-1556 and 75-1565

In the Supreme Court of the United States

OCTOBER TERM, 1976

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONER

v.

FEDERAL POWER COMMISSION

ASSOCIATED GAS DISTRIBUTORS, PETITIONERS

v.

FEDERAL POWER COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The Federal Power Commission established a two-tiered pricing methodology ("vintaging") for area gas rates in the Permian Basin Area Rate Proceeding of 1965.[1]

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[1] *Permian Basin Area Rate Proceeding* (Opinion No. 468), 34 FPC 159, rehearing denied (Opinion No. 468-A), 34 FPC 1068, remanded *sub nom. Skelly Oil Co.* v. *Federal Power Commission*, 375 F. 2d 6 (C.A. 10), on rehearing, 375 F. 2d 35, reversed in part *sub nom. Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *Federal Power Commission*), 390 U.S. 747.

The higher rate set a ceiling for "new" gas-well gas[2] dedicated to the interstate market after January 1, 1961, and was intended to stimulate exploration and development. A lower rate was set for "old" gas because the Commission concluded that price could not act as an incentive to further exploration and production[3] of such gas.

Experience did not bear out the Commission's expectations. Accordingly, in December 1972 the Commission issued Opinion No. 639,[4] which concluded that (48 FPC at 1309):

> Vintaging operates to discourage development of the full productive capacity of acreage committed to the interstate market, for even though such developmental drilling is undertaken at current costs, gas production obtained thereby is priced at the *lower* of two rates, when it is the *higher* of the two that is Commission-designed to provide the incentive for development of additional gas supplies [emphasis in original].

To help overcome this disincentive to full production of fields dedicated to the interstate markets, the Commission announced that the language of previous area rate orders which had established the two-tier pricing

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[2] "Gas-well gas" is gas produced by wells drilled for that purpose as distinguished from "oil-well gas," which is a by-product of oil production, and thus subject to different economic considerations. See *Permian Basin Area Rate Cases, supra*, 390 U.S. at 796.

[3] *Permian Basin Area Rate Cases (Continental Oil Co.* v. *Federal Power Commission), supra*, 390 U.S. at 796-797, 801-802.

[4] 48 FPC 1299, rehearing denied, 49 FPC 361, affirmed *sub nom. Shell Oil Co.* v. *Federal Power Commission*, 491 F.2d 82 (C.A. 5).

system would be "literally and strictly applied" (*id.* at 1310). Since those orders used the date of the gas contract to determine whether the gas was "old" or "new," Opinion No. 639 made clear that gas contracts signed after the designated area rate division date could receive the "new gas" rate even though the same gas service had existed under an earlier contract which had expired by its own terms. This would serve to abolish gradually the area two-tiered system.

On petitions for review, to which the petitioners here were parties, the United States Court of Appeals for the Fifth Circuit affirmed the Commission's interpretation of its vintaging regulation as "rational, reasonable, and therefore fully permissible." *Shell Oil Company* v. *Federal Power Commission*, 491 F. 2d 82, 89 (*Shell*).

In December 1972 Mobil Oil Company requested the Commission to authorize it to abandon certain natural gas sales to Shell Oil Company and approve a new contract to sell the gas in question to Texas Eastern Transmission Company. Mobil indicated that its Shell contract had expired by its own terms and, pursuant to Opinion No. 639, requested permission to collect the "new gas" rates for the gas to be sold to Texas Eastern. After permitting Associated Gas Distributors (AGD) to intervene, the Commission, on the basis of Opinion No. 639, approved the Mobil application. *Mobil Oil Corporation* (*Operator*), FPC Docket No. CI 73-450, CI 73-451, 49 FPC 1009.

Thereafter, a similar request for "new gas" area rates was filed by Continental Oil Company. The Commission permitted AGD and the Public Service Commission of the State of New York (PSCNY) to intervene and, on the basis of Opinion No. 639, accepted Continental's rate increase filings. *Continental Oil Company, et al.*, FPC Gas Rate Schedule No. 3 (AGD Pet. App. B, A-47 to A-49).

On petitions for review the court of appeals, with one dissent, affirmed the Commission's orders (AGD Pet. App. A, A-1 to A-46). It is this decision which petitioners now ask this Court to review.

Petitioners essentially contest the Commission's interpretation of its outstanding area rate orders as permitting "new gas" rates for production under contracts which are executed after the effective date of the area "new gas" rate, and which replace "old gas" contracts that have expired by their own terms. Petitioners see this as improperly allowing the gradual dissolution of "the two-tiered structure of rate regulation * * * " (AGD Pet. 8; see also PSCNY Pet. 10).

1. The permissibility of the gradual abolition of the two-tiered system through application of new rates to renewal contracts was decided adversely to petitioners in *Shell Oil Company* v. *Federal Power Commission (National Rate Case)*, 520 F. 2d 1061, 1076-1078 (C.A. 5), certiorari denied *sub nom. The California Company, et al.* v. *Federal Power Commission*, No. 75-1289, June 14, 1976.[5]

As the court of appeals stated in the *National Rate Case* (520 F. 2d at 1077-1078):

> The Commission is not bound by its previous policies. As this Court and the Supreme Court have noted on various occasions, the rate structures which introduced or adjusted vintaging were experimental. It is necessary without a doubt that agencies be permitted latitude to evaluate old experiments and modify or abandon them when their best judgment requires such a course of action.

[5]Both petitioners filed petitions for writs of certiorari in that case presenting essentially the same question raised here.

Moreover, because a *national* rate structure will in any event gradually replace the *area* rates at issue here, the gradual abolition of two-tiered *area* rates is of diminishing importance.

2. The precise question raised here and in the court of appeals below, the validity of Order 639, has also previously been decided adversely to petitioners. *Shell Oil Company* v. *Federal Power Commission, supra*, 491 F. 2d 82 (C.A. 5). As shown above, the Fifth Circuit in that case held that the Commission's "interpretation of its regulations' vintaging provisions is rational, reasonable, and therefore fully permissible" (491 F.2d at 89).

Petitioners' appeal to the Court of Appeals for the District of Columbia Circuit in this case presented the very question decided in *Shell, supra*. In its brief in the court of appeals here, which was filed before *Shell* was decided, PSCNY acknowledged that the sole issue here is the validity of Opinion 639, the very issue in *Shell*.[6] Petitioners, who were parties in *Shell*, should not be permitted to relitigate the issue in this case.

3. In any event the court of appeals here, as had the Fifth Circuit in *Shell*, correctly held that "[t]he Commission's interpretation of what constitutes 'new' gas,

[6]In its initial brief in the court of appeals, PSCNY said (Br. 36):

> The sole issue presented by the Commission's present action in authorizing the rate increases is the validity of its "interpretation" of its own rules. If it properly held in Opinion No. 639 (upon which the Commission based its order under review) that a producer may receive the higher new gas area rate for gas committed to the interstate market in the distant past solely because its initial contract term has expired and it has entered into a new contract, then its action is valid and must be affirmed. If not, its action must be set aside.

and application of that interpretation in the present cases, were reasonable actions falling within its authority" (AGD Pet. App. A, A-11). As the court stated (AGD Pet. App. A, A-7):

> Unhappily, the Commission's creation, vintaging, failed to achieve the desired results. Opinion No. 639 contains "substantial evidence" to support that finding of failure, 15 U.S.C. §717r(b). As the court said in *Shell* (491 F. 2d at 85 n 8), "no fact findings are disputed." The Opinion No. 639 findings did in fact include detailed discussion of national gas supply, area gas drilling and production activities, intrastate competition for new gas, the need for deep gas exploration, comparison with costs of supplemental gas, and change in costs of finding and producing new gas supplies. A major fact finding, pointing toward the failure of vintaging, was that the exploratory gas well count in the area had been 97 wells in 1968 and that within one year after the issuance of Order No. 411 in 1970, applying the vintaging concept to the area, the exploratory gas well count dropped to 47 wells.

The court also weighed petitioners' concern as to "the likelihood that the increased rates for flowing gas will lead to new gas efforts for the interstate market" (PSCNY Pet. 13). The court concluded (AGD Pet. App. A, A-10):

> No one can say with certainty that additional gas revenues will lead to an increased gas supply. It is apparent, however, that without sufficient revenue to support exploration for new deposits and further development of old deposits, an increased quantum of such activity is unlikely. The evidentiary factors discussed in Opinion No. 639 support that conclusion.

> The Commission's action, in modifying its earlier intepretation of its own vintaging mechanism, followed a pragmatic, non-doctrinaire approach based on its experience and expertise.

In the *Permian Basin Area Rate Cases, supra,* 390 U.S. at 791-792, the Court set the standards of review of Commission orders. The order must not abuse or exceed the Commission's authority; every "essential element" of the order must be supported by "substantial evidence"; and the order must "reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors" for their risks, while simultaneously providing "protection to the relevant public interests, both existing and foreseeable." In *Mobil Oil Corporation* v. *Federal Power Commission,* 417 U.S. 283, 309, the Court added that:

> application of [these] three criteria of judicial review of Commission orders is primarily the task of the courts of appeals.

The Court noted that it would intervene to review Commission action only in the "rare instance when the standard [of *Permian*] appears to have been misapprehended or grossly misapplied." 417 U.S. at 310.

No such "rare instance" has been shown here. The court of appeals found that the Commission's orders were supported by "substantial evidence" and "were reasonable actions falling within its authority" (AGD Pet. App. A, A-7, A-11).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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